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INSURANCE COMMISSIONER
COMPANY SUPERVISION

- ☐ EXPEDITE
☒ No Hearing Set
☐ Hearing is Set

Date:

Time:

The Honorable Chris Wickham

STATE OF WASHINGTON
THURSTON COUNTY SUPERIOR COURT

MIKE KREIDLER,
INSURANCE COMMISSIONER,

Petitioner,

v.

WESTERN UNITED LIFE
ASSURANCE COMPANY,

Respondent.

NO. 04-02-00406-1

FIFTH REPORT OF RECEIVER

COMES NOW, Mike Kreidler, the Insurance Commissioner of the State of Washington and Statutory Receiver of WESTERN UNITED LIFE ASSURANCE COMPANY ("WESTERN UNITED"), James T. Odiome, Deputy Insurance Commissioner and court-appointed Receiver of WESTERN UNITED, and Wayne C. Metcalf, III, Special Deputy Insurance Commissioner and court-appointed Chief Deputy Receiver of WESTERN UNITED, by and through their attorneys, Rob McKenna, Attorney General, and Christina Gerstung Beusch, Assistant Attorney General, and hereby submit the Fifth Report of Receiver, pursuant to RCW 48.31.040(5), and state as follows:

1. *Order of Rehabilitation.* On March 2, 2004, this Court entered an Order of Rehabilitation and Appointment of Receiver placing WESTERN UNITED into rehabilitation

proceedings pursuant to Chapters 48.31 and 48.99 RCW, and appointing the Statutory Receiver, Receiver and Chief Deputy Receiver (hereinafter collectively "Receiver").

2. *Amended Order of Rehabilitation.* On October 22, 2004, this Court entered an Amended Order of Rehabilitation and Appointment of Receiver that replaced the original Order of Rehabilitation and Appointment of Receiver and related back to the original issuance date of March 2, 2004.

3. *Accounting to the Court.* RCW 48.31.040(5) and the Amended Order of Rehabilitation require that the Receiver make accountings to the Court not less than semiannually.

4. *Financial Report.* The June 30, 2006 quarterly statutory financial statement of WESTERN UNITED may be viewed on the website of the Office of Insurance Commissioner at www.insurance.wa.gov. As of June 30, 2006 WESTERN UNITED had capital and surplus, as calculated under Statutory Accounting Principles ("SAP"), in the amount of \$39,897,199. SAP is the accounting framework to be used by insurance companies transacting business in Washington. See RCW 48.05.073 and WAC 284.07.050. The December 31, 2005 statutory annual statement of WESTERN UNITED reported capital and surplus of \$41,663,645. The six-month decrease in capital and surplus of \$1,766,446 is comprised of the following:

Annual statutory statement, December 31, 2005	\$41,663,645
Audit adjustments:	
Additional capital losses on mortgages	(1,083,196)
Write-off mortgage loan accrued interest	(484,353)
Decrease asset valuation reserve	1,083,196
Increase gross deferred tax asset	548,642
Increase non-admitted deferred tax asset	<u>(5,111,150)</u>
Audited Financial statement, December 31, 2005	\$36,616,784

1	Net loss from operations	(6,641,481)
2	Net realized capital losses	(2,093,389)
3	Net unrealized capital gains	10,262,886
4	Increase in net deferred income tax	2,027,756
5	Decrease in non-admitted assets	3,941,030
6	Increase in asset valuation reserves	(3,216,387)
7	Change in surplus from reinsurance	<u>(1,000,000)</u>
8	Quarterly statutory statement, June 30, 2006	\$39,897,199

9 Net realized capital losses during the first six months of 2006 are comprised of the
10 following approximate amounts (in millions):

11	Sales and adjustment of real estate	\$6.9 million
12	Securities losses and impairments	(1.1) million
13	Mortgage loan losses and reserves	<u>(7.9) million</u>
14	Realized net capital losses	\$(2.1) million

15 The net realized gain on the sale of real estate included a single gain in the amount of
16 approximately \$6.7 million from the sale of certain property in Hawaii known as Dillingham
17 Ranch. The net realized loss from securities included an impairment loss in the amount of
18 approximately \$0.8 million on a single defaulted mortgage-backed bond holding. The net
19 realized loss on mortgages included approximately \$0.9 million of loss upon foreclosure of
20 predominately smaller-balance residential loans, approximately \$0.9 million of additional loss
21 reserves on predominately smaller-balance residential loans, approximately \$6.7 million of
22 additional loss reserves on a single defaulted commercial loan, and an offsetting net reduction
23 of approximately \$0.6 million of loss reserves on other commercial loans. Offsetting the
24 realized capital losses on mortgages loans were unrealized gains of approximately \$15 million
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1 (before deferred tax effect), including approximately \$8.5 million released upon sale of a
2 mortgage note secured by real property in Hawaii. The remainder of the unrealized gain was
3 derived from converting temporary mortgage loss reserves to realized mortgage loss reserves.

4 As indicated in its Fourth Report of Receiver, WESTERN UNITED engaged the firm
5 of Amper, Politziner & Mattia, P.C ("Amper") of Edison, New Jersey to conduct an audit of
6 WESTERN UNITED's statutory financial statements for 2005. Amper issued its report on
7 May 24, 2006 and the report was subsequently filed with the Insurance Commissioner on June
8 2, 2006. The report may be viewed on the website of the Office of Insurance Commissioner at
9 www.insurance.wa.gov. Western expects to retain Amper to audit its 2006 annual statutory
10 financial statements.
11

12 During the period of its receivership and rehabilitation through June 30, 2006,
13 WESTERN UNITED has been able to reduce its combined holdings of mortgages and real
14 estate by approximately 85%. As of June 30, 2006 WESTERN UNITED held admitted
15 mortgage loans and real estate with carrying values of \$47,392,060 and \$87,282,706,
16 respectively. Together, these holdings totaled \$134,674,766 at June 30, 2006. These figures
17 compare to mortgage loan and real estate with carrying values as of December 31, 2003 of
18 \$815,407,649 and \$105,818,628, respectively. Together, these holdings totaled \$921,226,277
19 at December 31, 2003, which was the last reporting period preceding WESTERN UNITED's
20 placement into receivership.
21

22 RCW 48.05.340 sets forth the minimum capital and surplus for authorized insurance
23 companies such as WESTERN UNITED. WESTERN UNITED is in compliance with those
24 minimum requirements. Additionally, RCW 48.05.430 through .490 require an authorized
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1 insurance company to have total adjusted capital and surplus in a sufficient amount as
2 determined by the company's Risk-Based Capital ("RBC") formula. Based on its RBC score
3 at the end of 2005, as adjusted for additional items recorded in its 2005 annual audit,
4 WESTERN UNITED was in a regulatory-action level status. As a result of this status,
5 WESTERN UNITED was required to prepare an action plan designed to correct the RBC
6 deficiency. On September 14, 2006, the Office of Insurance Commissioner approved
7 WESTERN UNITED's revised RBC action plan. Based upon its financial position and results
8 of operations through June 30, 2006, WESTERN UNITED has calculated an interim RBC
9 score. That score shows that WESTERN UNITED has improved its score by one action level,
10 and is currently at the company action level.
11

12 5. *Retention of Policyholders.* Western United has experienced an increase in
13 withdrawals for deferred annuity contracts when compared to the same period one year earlier.
14 For the six-month period ending August 31, 2006, Western United distributed \$135.8 million,
15 an increase of 68% from the corresponding period one year earlier when Western United
16 distributed \$81.0 million. However, this increase was expected due to the expiration of the
17 penalty period for early withdrawals on a large number of policies and the recent maturity of a
18 large number of 3-year Interest Premium Return ("IPR") annuity products. When an IPR
19 annuity matures it forces the total surrender of the annuity value. Western United expects
20 withdrawals to maintain at current levels through the end of the year at which time they should
21 begin to decline slightly. In spite of the current level of withdrawals, WESTERN UNITED has
22 not experienced liquidity issues caused by withdrawals.
23

24 6. *Reinsurance.* WESTERN UNITED is reinsured under reinsurance agreements
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1 with Old Standard Life Insurance Company ("Old Standard"), a former affiliated entity that
2 was placed into receivership by the Idaho State Department of Insurance on March 2, 2004.
3 The "reinsurance receivable" from Old Standard is WESTERN UNITED's single largest asset.
4 The Idaho Department of Insurance, which supervises Old Standard's receivership under the
5 authority of the Idaho Insurance Commissioner, has represented to the WESTERN UNITED
6 Receiver that it intends to keep the reinsurance payments of Old Standard to WESTERN
7 UNITED current and that Old Standard will not pay lower priority creditors prior to satisfying
8 its reinsurance obligations to WESTERN UNITED in full. As of June 30, 2006, WESTERN
9 UNITED had the following balances under the reinsurance agreements:

11	Statutory-basis ceded reserve credit	\$72,645,697
12	Reinsurance recoverable on unpaid claims	2,336,569
13	Reinsurance recoverable on paid claims	<u>2,427,870</u>
14	Total reinsurance balances	\$77,410,136

15 Of those balances shown above, \$323,901 was in arrears by eight days at June 30, 2006. The
16 remaining balance was current under the agreements, which have remained current through the
17 date of this report. Settlements under the agreements through June 30, 2006 have been for cash
18 totaling \$8,967,764. Old Standard's remaining insurance liabilities consist solely of
19 obligations to WESTERN UNITED under these reinsurance agreements.
20

21 7. *Operating Expenses.* WESTERN UNITED continues its efforts to reduce
22 operating expense. Since August 2004, staffing at WESTERN UNITED has decreased by 102
23 (from 196 to 94), a reduction of 52.0%. As stated in the Fourth Report of Receiver, substantial
24 staffing reductions have been made possible by WESTERN UNITED's efforts to reallocate its
25 portfolio to be more closely aligned with that of a more typical annuity company and by
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1 retaining Midland Loan Services, Inc. to assist with the management of WESTERN UNITED's
2 real estate and commercial loan portfolios. Corresponding with the reduction in staff, since
3 August 2004 the running rate of total annual compensation (salary, benefits, taxes and
4 excluding bonuses) at WESTERN UNITED has decreased from \$11.8 million to \$6.6 million,
5 a reduction of 44.1%. Through July 2006, WESTERN UNITED's actual non-commission
6 expenses were \$20.7 million, which if annualized $((20.7 \div 7) \times 12)$ is almost \$2.5 million
7 below that of 2005 non-commission expenses of \$37.9 million. WESTERN UNITED's actual
8 non-commission expenses through July 2006 were comprised of \$4.6 million of salary, wage,
9 benefit & tax expenses (which included approximately \$0.7 million in accruals for employee
10 retention Program), \$3.4 million of legal expenses (including legal expenses related to pre-
11 acquisition real estate matters, lending litigation, the bankruptcy action involving its affiliates
12 and third-party claims), \$5.8 million of real estate owned holding costs (including \$0.8 million
13 in other legal expenses related to post-acquisition real estate matters), \$2.1 million of public
14 accountant and consulting actuarial expenses, \$1.0 million of insurance coverage not related to
15 real estate owned, and \$3.8 million of various other general expenses.

16 In addition to normal operating expenses, it should be noted that WESTERN UNITED
17 has incurred significant extraordinary expenses arising out of its lawsuit against Ernst &
18 Young LLP and the bankruptcy cases involving WESTERN UNITED's indirect parent
19 company Metropolitan Mortgage & Securities Co., Inc ("Metropolitan") and its sibling,
20 Summit Securities, Inc. ("Summit"). Western United believes that expenses incurred will be
21 exceeded by the potential for substantial recoveries. These expenses are included in the \$3.4
22 million of legal expenses set forth above.

23 8. *Issues with Parent and Affiliate Companies.* Metropolitan and Summit
24 (collectively, the "Debtors") filed for chapter 11 bankruptcy protection on February 4, 2004, in
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1 the United States Bankruptcy Court for the Eastern District of Washington Spokane Division
2 (the "Bankruptcy Court").

3 On September 26, 2005 the Bankruptcy Court approved a Disclosure Statement with
4 respect to a plan of reorganization prepared by the Debtors and their respective Creditor's
5 Committees (the "Plan"). WESTERN UNITED believed that the Plan, as filed, would result in
6 material adverse tax consequences to WESTERN UNITED. The parties subsequently agreed
7 to facilitate a transaction designed to avoid the adverse tax consequences created by the Plan.
8 That transaction closed on December 30, 2005. As a result, WESTERN UNITED withdrew its
9 remaining objections to the Plan and changed its vote to accept the Plan. An order of the
10 Bankruptcy Court confirming the Plan was entered on February 13, 2006.

11
12 The Plan provides for assets of the bankruptcy estate to be transferred to two (2)
13 Creditors Trusts created under the Plan: one for Metropolitan and one for Summit. At the time
14 of confirmation of the Plan, WESTERN UNITED was a wholly owned subsidiary of Western
15 United Holding Company ("WUHC"). WUHC, in turn, was a wholly owned subsidiary of
16 Metropolitan; however, WUHC owed and still owes substantial sums to public investors
17 holding securities issued by WUHC. Notwithstanding the obligations to these third parties,
18 WESTERN UNITED is an indirect subsidiary of Metropolitan. When the Plan was
19 consummated on April 25, 2006, among other things, Metropolitan transferred its interest in
20 WUHC to the Metropolitan Creditors' Trust. However, by order of this Court, WESTERN
21 UNITED remained, and continues to remain, under the sole control of the Insurance
22 Commissioner and, therefore, WESTERN UNITED cannot and did not relinquish control over
23 it to the Metropolitan Creditors' Trust. A change of control of WESTERN UNITED and the
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1 | eventual emergence of the company from receivership can only occur with the approval of the
2 | Insurance Commissioner and this Court.

3 | WESTERN UNITED has asserted significant claims against the Debtors. The Debtors
4 | have disputed most of these claims. In addition, Metropolitan has asserted various claims
5 | against WESTERN UNITED which would operate as offsets against any claims allowed in
6 | favor of WESTERN UNITED. WESTERN UNITED believes it has defenses against most of
7 | Metropolitan's claims and that, in any event, WESTERN UNITED's claims against the
8 | Debtors greatly exceed the Debtors' claims against WESTERN UNITED. The parties
9 | attempted mediation in order to resolve their various disputes, including disputes about the
10 | claims. Objections to WESTERN UNITED's claims have been filed in the Bankruptcy Court.
11 | WESTERN UNITED has responded to these objections. No hearing has been set with respect
12 | to the claims or objections.
13 |
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15 | Prior to the evidentiary hearing that was scheduled in the Bankruptcy Court for May 17
16 | and 18, 2006 to "estimate" WESTERN UNITED's claims for the purpose of establishing a
17 | reserve to protect WESTERN UNITED from dissipation of the Debtors' assets before
18 | WESTERN UNITED's claims are allowed, the parties entered into an agreement which,
19 | among other things, estimated WESTERN UNITED's claims for the purpose of the initial
20 | distributions of the Debtors. The parties agreed that, for purposes of the initial distribution by
21 | Metropolitan, WESTERN UNITED's claims would be estimated at \$50,000,000 and that a
22 | reserve equal to the amount that would have been distributed to WESTERN UNITED if such
23 | claims were allowed would be established in a separate, segregated interest-bearing trust
24 | account. The parties further agreed that, for purposes of the initial distribution by Summit, no
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1 estimate of WESTERN UNITED's claim would be made and no reserve would be established.
2 The agreed upon estimation does not represent concessions by any of the parties that the
3 estimate reflect WESTERN UNITED's actual claims nor does it represent a ceiling on, the
4 aggregate face amount of WESTERN UNITED's claims. The parties further agreed to provide
5 notice to each other prior to (i) any further distribution by the Debtors or (ii) any request to
6 schedule a hearing for the purpose of adjudicating WESTERN UNITED's claims against the
7 Debtors. Under the Agreement estimating WULA's claims approved by the Bankruptcy Court
8 on June 1, 2006, notice of a distribution could not be given prior to December 31, 2006, and
9 any claim adjudication hearing could not occur prior to March 31, 2007.
10

11 9. *Continued Prospects for Rehabilitation.* The Washington Office of the
12 Insurance Commissioner continues to be involved in discussions with a potential purchaser of
13 WESTERN UNITED. If mutually agreed upon terms can be reached, the Receiver will file
14 with the Court, with notice to all interested parties, a petition for approval of the sale. If terms
15 cannot be agreed upon with a potential purchaser at this time, the Receiver will continue to
16 operate WULA consistent with the plans discussed herein in order to protect the policyholders.
17

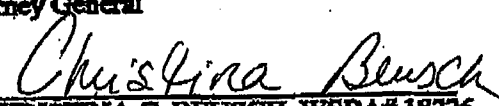
18 As indicated in previous Reports of Receiver and as part of its efforts to achieve a
19 successful rehabilitation, WESTERN UNITED is continuing its efforts to sell its real estate
20 assets and resolve commercial loans and will be placing the proceeds in investment vehicles
21 typical of annuity companies such as investment grade securities. Currently, the total statutory
22 book value (as of August 31, 2006) of WESTERN UNITED's commercial real estate
23 properties that are under contract for sale (subject to the prospective purchasers completing
24 their due diligence) is approximately \$38M or approximately 45% of the total statutory book
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1 value (as of August 31, 2006) of its commercial real estate portfolio. All of these potential
2 sales are currently scheduled to close before the end of 2006.¹ WESTERN UNITED's
3 intention is to sell or resolve its remaining mortgage and real estate portfolios prior to the end
4 of 2007. Also as part of its continued efforts towards rehabilitation, WESTERN UNITED will
5 continue its efforts to reduce operating expenses and carefully monitor extraordinary expenses.
6

7 DATED this 29th day of September 2006.

8 
9
10 WAYNE C. METCALE, III,
11 Chief Deputy Receiver for
12 Western United Life Assurance Company

13 Presented by:
14 ROB MCKENNA
15 Attorney General

16 By: 
17 CHRISTINA G. BEUSCH, WSBA# 18226
18 Assistant Attorney General
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25 ¹ As previously experienced, any of these potential transactions could fail to close
26 as anticipated which would necessitate further sale efforts.

1 ☐ EXPEDITE
2 ☒ No Hearing Set
3 ☐ Hearing is Set
4 Date:
5 Time:
6 The Honorable Chris Wickham

7
8 **STATE OF WASHINGTON**
THURSTON COUNTY SUPERIOR COURT

9 **MIKE KREIDLER,**
10 **INSURANCE COMMISSIONER,**

11 **Petitioner,**

12 **v.**

13 **WESTERN UNITED LIFE**
ASSURANCE COMPANY,

14 **Respondent.**

NO. 04-02-00406-1

**CERTIFICATE OF SERVICE OF
FIFTH REPORT OF RECEIVER**

15
16 This will hereby certify that on the 29th day of September, 2006, I mailed a true and
17 correct copy of the **Fifth Report of Receiver** in this matter, via the United States Mail, first-
18 class postage prepaid, in sealed envelopes, at Olympia, WA, to the following interested
19 parties:

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DATED this 29th day of September, 2006.



Nicole Teeter, Legal Assistant



GCE

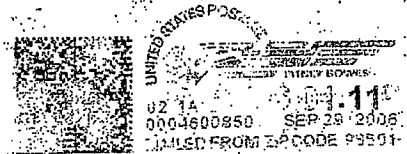
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